FitchRatings

RATING ACTION COMMENTARY

Fitch Rates $900MM Los Angeles County, CA Notes 'F1+'; Affirms Outstanding Ratings; Outlook Stable

Fri 03 Jun, 2022 - 2:20 PM ET

Fitch Ratings - San Francisco - 03 Jun 2022: Fitch Ratings has assigned a rating of 'F1+' to following Los Angeles County, CA issuance:

--$900 million Los Angeles County 2022-23 tax and revenue anticipation notes (the notes).

In addition, Fitch has affirmed Los Angeles County's (the county) Issuer Default Rating (IDR) at 'AA+'; all certificates of participation (COPs) and lease revenue bonds listed at the end of this press release at 'AA'; and $1 billion 2021-22 tax and revenue anticipation notes (TRANs) at 'F1+.'

The Rating Outlook on all the long-term ratings is Stable.

The notes are scheduled to price June 7 and mature on June 30, 2023. Proceeds will be used to manage cash flow for general fund operations for fiscal 2023.

SECURITY

The 2022-23 notes are general obligations of the county, payable from unrestricted general fund revenue attributable to fiscal 2023. The 2022-23 TRANs have a first lien on the pledged revenues.

ANALYTICAL CONCLUSION

The 'F1+' short-term ratings on the 2021-22 and 2022-23 TRANs correspond to the county's IDR. The combination of pledged revenues and court-verified borrowable resources provides very strong debt service coverage (projected to be in excess of $13 billion, estimated to cover note principal and interest 14.9x). Full note principal and interest set-asides occur well in advance of the 2021-22 and 2022-23 TRANs' maturities on June 30, 2022 and 2023, respectively.

The county's 'AA+' IDR reflects the combined strength of the county's solid revenue performance, its large and diverse economy, a moderately low long-term liability burden and superior gap-closing capacity. The county's demonstrated ability to cut spending, sound financial cushion and limited revenue cyclicality offset the county's exposure to federal and state funding decisions, Department of Health Services (DHS) operations and constraints on the county's independent legal ability to raise revenues. The ongoing resumption of normal business activity has resulted in a return to economic and revenue gains in line with pre-pandemic trends.

Economic Resource Base

The county covers over 4,000 square miles and includes 88 incorporated cities and 100 school districts. With a population exceeding 10 million, it is more populous than most U.S. states. The county's economy represents over one-quarter of California's total economy.

KEY RATING DRIVERS

Revenue Framework: 'aa'

The county's revenues demonstrate limited volatility, reflecting the size and maturity of the economy and tax base, which retains a large Proposition 13 cushion. Growth prospects for revenues are solid. The county's independent legal ability to raise revenues is restricted by state law but is satisfactory since it has control over fees and charges for services.

Expenditure Framework: 'aa'

Fitch expects expenditure growth to be in line with, to marginally above, future revenue growth in the absence of policy action. The county continues to enjoy solid expenditure flexibility, although policy changes and potential litigation outcomes could somewhat constrain that flexibility in the future. Pension and other post-employment benefit (OPEB) obligation contributions have been ramped up to pay down significant liabilities; however, such payments have remained a relatively stable percentage of spending in recent years.

Long-Term Liability Burden: 'aa'

The county's long-term liability burden for debt and pensions is moderately low relative to total personal income. The majority of debt is issued by overlapping jurisdictions.

Operating Performance: 'aaa'

The county demonstrates an ongoing commitment to support a strong financial cushion. This cushion is aided in part by the DHS's stable financial position, which is supported by a five-year extension of full reimbursement for certain safety net hospital costs. The county, which has superior gap-closing capacity, is very well positioned to address economic downturns.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--A sustained long-term liability burden less than 10% of personal income;

--Increased revenue growth rate at or above U.S. GDP growth.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Slower expected long-term revenue growth, close to the rate of inflation;

--Pressured financial flexibility due to slower revenue growth, expenditure growth that outpaces revenues, and/or sustained and material reductions in reserves.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Federal and State Pandemic-Related Aid

The county has benefitted from $1.2 billion in Coronavirus Aid, Relief, and Economic Security (CARES) Act funding, followed by $1.9 billion in American Rescue Plan Act (ARPA) funding.

Fiscal 2021 and 2022 Operations

The county ended fiscal 2021 with a $414 million surplus and added $344 million to unrestricted fund balance bringing the total to $4.65 billion, equal to almost 20% of fiscal 2021 spending. The county balanced its $29.9 billion fiscal 2022 general fund budget (general and hospital enterprise funds) with $610 million higher revenue than the previous year's final budget, primarily due to increased property tax revenues, proposition 172 public safety sales tax receipts and state realignment revenues. The final adopted budget added 224 positions and emphasizes safety net services, criminal justice reform, and COVID-19 public health response.

The budget did not include the county's ARPA funding. Rather, these funds are deposited into a special revenue fund and only transferred into the general fund when expended. For example, in a fiscal 2022 mid-year budget adjustment, the board approved a $975 million spending plan and added about $600 million in ARPA funds to the budget, mostly for one time uses but also to add back some spending cuts made at the onset of the pandemic.

The county expects to end fiscal 2022 with a surplus and modestly higher fund balance.

Fiscal 2023 Budget

The county's fiscal 2023 budget increases property taxes by $381 million, driven by a projected 6% increase in taxable assessed value (TAV). Additional fiscal 2023 discretionary revenue increases include $69 million in residual property taxes from former redevelopment agencies, almost $70 million in higher proposition 172 public safety sales taxes, higher starting fund balance and better realignment revenue. The fiscal 2023 budget also adds four new departments - justice, youth development, aging, and economic opportunity - though two of these operations have previously existed in other departments. The budget adds over 500 new positions, mostly in public health, health services and safety-net services, and these are not funded from discretionary revenues.

Care First, Jails Last

Measure J, approved by voters in November 2020, requires at least 10% of locally generated unrestricted general fund revenues (as determined through the annual budget process) be allocated annually to community programs and alternatives to incarceration, with a three-year ramp-up period. Measure J was declared unconstitutional in June 2021, and this decision is under appeal by the county. Until resolved by the courts, the county board of supervisors retains full authority to appropriate moneys for these purposes, and the fiscal 2022 budget earmarked an initial $100 million for "Care First, Jails Last" spending as originally conceived under Measure J. The county plans to continue to grow the program, and achieve the full allocation to Care First, Jails Last - estimated at about $300 million annually - by fiscal 2024. The fiscal 2023 budget includes $200 million for Care First, Jails Last, consistent with the planned $100 million annual increase.

While manageable, ringfencing general fund revenues could constrain the county's flexibility in spending. However, as a plan adopted by the board rather than the voters, the board retains full flexibility in appropriating such funds; however, reducing such funding could pose its own political and logistical challenges.

Homelessness Litigation

In connection with litigation filed against the county and the city of Los Angeles in March 2020 regarding homelessness, a district court issued a preliminary injunction, compliance with which the county estimated would cost $448 million. The preliminary injunction was later vacated by the Ninth Circuit Court of Appeals, relieving the county of the near-term pressure to fully absorb this level of ongoing cost. Efforts to settle the lawsuit continues. Regardless of the outcome of the litigation, Fitch expects ongoing pressure on the county to increase spending to alleviate homelessness. For fiscal 2023, the county has budgeted over $1 billion to expand affordable housing, funded in part from almost $500 million in measure H sales tax revenues allocated to homeless services and housing.

Despite these growing demands on the county's budget, the county continues to increase the annual appropriation to its OPEB trust as part of a plan to reach full actuarial funding by fiscal 2028; achieving this objective would stabilize its annual contribution requirements thereafter.

The county is building up its reserves to provide a glidepath for reducing spending when recent strong revenue growth subsides. In addition, the county notes that when new programs receiving pandemic-related funding, such programs were not permitted to hire permanent staff. Rather, like other grant-funded programs, they were set up be shut down if funding went away.

CREDIT PROFILE

Los Angeles County is a major economic and manufacturing center, and incorporates two ports and an airport that are typically among the busiest in the world. TAV experienced strong growth over the past decade after very small recessionary declines, reflecting the county's highly developed and mature tax base and large Proposition 13 cushion with a significant, albeit slowly declining, portion of properties listed on the tax roll at well below market value. While the majority of recent growth is tied to ownership transfers of existing properties and inflation, ongoing new development and redevelopment projects continue to support future tax base growth.

Fiscal 2022 represents the 11th consecutive year of tax base growth, with an almost 4% increase to over $1.76 trillion. The fiscal 2023 TAV gain is estimated at 6%. Since fiscal 2017, annual TAV gains have been 6% every year except fiscal 2022. The size and diversity of the economy that underpins the county's tax base remain a credit strength. The residential real estate market continues to perform strongly. After dropping sharply in 2020, construction lending rebounded for the commercial real estate sector. The assessor states there were no changes in commercial TAV and no increase in property tax delinquencies for (year).

The county's unemployment rate has historically been higher than the nation's, a gap that was exacerbated by pandemic mitigation measures. The county's unemployment rate shot up to 20.3% in April 2020 from 4.6% in February 2020. Unemployment rates subsequently improved significantly; the county's unemployment rate in March 2022 was 4.9%, moderately above the unemployment rates of the state (4.2%) and the nation (3.8%). Wealth indicators are below the state but generally above or in line with the nation, reflecting the county's incorporation of some highly urbanized and low-income areas.

Revenue Framework

Over half of general fund revenues in fiscal 2021 came from federal and state funding for social services, although this amount can fluctuate significantly through the economic cycle due to caseloads, reimbursement timing and state budget issues. Locally generated taxes and charges for services are the two other key revenue sources at 30% and 13% of fiscal 2021 general fund revenues, respectively.

Pre-pandemic, the 10-year CAGR for total general fund revenue growth was slightly below national GDP but above the rate of inflation. Excluding intergovernmental revenues, the 10-year CAGRs for locally controlled revenues typically outperform national GDP growth, except in fiscals 2017 to 2019. Fitch expects future intergovernmental revenues will be determined by federal and state policy decisions and economic performance, while locally controlled revenues will mirror future economic trends at the county level.

The county has satisfactory independent revenue-raising capacity relative to its modest historical cyclical revenue declines. However, its ability to raise revenues is constrained by state laws (in particular, Propositions 13 and 218) that require voter approval for tax increases. Independent revenue-raising ability is largely limited to licenses, permits, fines and charges for service.

Expenditure Framework

The majority of fiscal 2021 general fund expenditures were related to public assistance, public safety and health and sanitation services, all key roles for California county governments. Personnel costs remain the largest driver of expenditure increases.

The county operates within a strong labor environment, and labor has the ability to strike. Labor relations are nevertheless productive. In their one-year labor agreement extensions for fiscal 2022, all major employee groups accepted a $1,000 per employee payment in lieu of a cost of living adjustments, with a $500 appreciation payment for front line workers and an additional bonus of up to $650 for DHS employees. Fringe benefit plans were increased by 2.5%. The county recently reached a tentative three-year agreement with Service Employees International Union (SEIU), and expects agreements yet to be closed to have similar terms. The SEIU agreement includes salary increases of 5.5% in October 2022 and 3.25% in October 2023 and 2024, as well as 2%-4% increases in fringe benefits. The difference between the assumed and the currently forecasted salary costs are modest and expected to be absorbed in the budget through higher than budgeted property taxes.

The pace of spending growth absent policy actions is likely to be in line with, to marginally above, revenue growth patterns given high-needs communities within the county. Fitch expects the county will continue to control expenditures aggressively.

Fixed carrying costs are moderate and include gradually increasing OPEB payments in an effort to reach actuarial funding which the county expects to do around fiscal 2028. Fitch views this effort positively as it will help contain future expenditure growth as well as provides a measure of budgetary flexibility. The county's pension system contribution rates increased by 9% in fiscal 2022 primarily due to past investment underperformance and the phase-in of revised economic assumptions.

Long-Term Liability Burden

Direct and overlapping debt of $42.7 billion represents nearly 60% of the county's overall long-term liability burden. Of that debt, the vast majority was issued by overlapping jurisdictions, which retain considerable unissued bond authorizations.

The Los Angeles County Employees Retirement Association (LACERA) reported a $17.4 billion net pension liability at June 30, 2021 (an asset-to-liabilities ratio of 76%, assuming a 7% discount rate). Fitch's standard 6% discount rate increases the net pension liability to an estimated $28.8 billion, reducing the asset-to-liabilities ratio to 66%. In January 2020, LACERA lowered the discount rate to 7%; the resulting increase to the employer contribution rate is being phased in over three years through fiscal 2023.

Combining debt and Fitch-adjusted pension liabilities, the county's overall long-term liability burden is a moderately low burden on county taxpayers' resources, at just over 10% of personal income.

The county's unfunded actuarially accrued OPEB liability totaled $29.5 billion in fiscal 2021. The county has the legal ability to reduce this liability. The county enacted OPEB reforms in 2015 and is increasing its annual contributions by $60 million annually, funded in significant part by maximizing subvention revenues from other governments. Fiscal 2023 represents the eighth year of a multiyear plan to reach the full actuarially required OPEB contribution in fiscal 2028. In addition to the county's irrevocable OPEB trust (over $2.4 billion as of February 2022), LACERA has a reserve for annual healthcare premium fluctuations ($148 million as of Aug. 31, 2021).

Operating Performance

The Fitch Analytical Stress Test (FAST) scenario analysis tool relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria. The FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance. Hence, actual revenue declines would vary from FAST results and Fitch expects the county would implement decisive corrective actions to offset them. The county demonstrates minimal revenue volatility under the FAST model's moderate scenario.

In recent years, the county has prioritized maintenance of strong general fund balances and continued strengthening its reserves in the face of increasing employee remuneration costs. An unrestricted general fund balance of over $4.6 billion in fiscal 2021 (nearly 20% of general fund spending) provides a considerable cushion against revenue declines. For fiscal 2022, the county expects the general fund balance to increase modestly due to higher than budgeted revenues, federal pandemic-related aid and lower than budgeted expenditures.

The county has two specific reserve policies. First, its $732 million rainy day fund balance meets the county's policy goal of 10% of discretionary revenues. The county recently revised its rainy-day funding requirement to 17% of locally generated revenues (roughly two months of such revenues) pursuant to the GFOA's recommended best practices. The county expects its rainy-day reserve to remain around 10% of discretionary spending at least through fiscal 2023, and to reach the 17% goal in over several years.

Second, the county has a policy to set aside 5% to 10% of new ongoing discretionary revenues annually as an appropriation for contingencies. The fiscal 2023 budget includes a $45.7 million contribution to comply with that policy.

Fitch expects the county will continue to prudently manage its liquidity and costs to maintain a financial cushion consistent with the current rating. This expectation is based largely on the recently positive operating results and strong fiscal trend. The county expects to close fiscal 2022 with a general fund cash balance of almost $1.7 billion, excluding federal pandemic-related aid.

Department of Health Services

The county operates the second largest public health system in the nation. The general fund is responsible for DHS administration, online medical records and the managed care program. State Assembly Bill (AB) 85 (year) established a maintenance of effort funding requirement for the annual county general fund contribution to the DHS, with 1% increases annually. On this basis, the base net county contribution (NCC) has been stable, increasing 1% annually since fiscal 2015 to $357 million in fiscal 2023. County officials report the base NCC represented around 5% of the DHS's total budget in fiscals 2019 to 2023.

In addition to the base NCC, other departments transfer resources to support the DHS's absorption of correctional health services. The county board of supervisors also provided new funding for strategic initiatives and the state increased pass-through funding for mental health programs. Consequently, gross county contribution increases in recent years were driven primarily by policy decisions rather than DHS budgetary pressures.

The DHS expects to end fiscal 2022 with a fund balance of almost $1.8 billion when including a $685 million reserve for long-term receivables. The DHS expects to use substantial fund balance in fiscal 2023 and 2024 as it works to achieve cost efficiencies and implement new revenue programs. These forecasts are inherently conservative, based on confirmed revenues only.

County general fund support for the DHS's cash position has reduced sharply. The balance of general fund working capital loans to hospitals remains at zero. The DHS has benefited from $503 million in federal and state pandemic-related aid, and will receive some ARPA funding through the county for non-medical services. In addition, DHS benefits from the extension of full reimbursement for certain safety net hospital costs and the replacement state funding waiver which extends through December 2026 and which provides stable to increasing state funding.

The county is working on a $1.7 billion Harbor-UCLA Medical Center replacement project, the cost of which will be shared between the DHS (90%) and the county's Department of Mental Health (10%). The department will fund its share from available resources and by leveraging federal and state revenues through Medi-Cal to fund the construction of psychiatric emergency service facilities and inpatient beds. The general fund will not be contributing to the DHS portion of the project, which is due to be completed in 2027.

Related Ratings

Fitch has affirmed at 'AA' the following outstanding ratings, each of which is linked to the county's IDR:

--Los Angeles County Public Works Financing Authority lease revenue bonds (multiple capital projects), 2010 series B (Build America Bonds); lease revenue bonds (multiple capital projects II), series 2012; lease revenue bonds (multiple capital projects), series 2015A; lease revenue bonds (master refunding project), series 2015B (tax-exempt) and 2015C (federally taxable); lease revenue bonds, 2016 series D; lease revenue bonds 2019 series E-1 and E-2; lease revenue bonds, 2020 series A (Los Angeles Museum of Art

Building for the Permanent Collection Project) (Green Bonds); lease revenue bonds, 2021 series F (green bonds) and lease revenue bonds, 2022 series G.

--COPs, series 2012 refunding COPs (Disney Concert Hall Parking Garage);

--Sonnenblick-Del Rio El Monte Asset Leasing Corporation senior COPs, series 1999 (Department of Public Social Services Facility) and series 2001 (Department of Public Social Services Facility - Phase II);

--Sonnenblick-Del Rio West Los Angeles Leasing Corporation senior COPs, series 2000 (Department of Public Social Services Facility);

--Los Angeles County Capital Asset Leasing Corporation lease revenue bonds (LAC-CAL equipment program), series 2020A;

-- Los Angeles County Facilities, Inc. lease revenue bonds, series 2018A (Vermont Corridor County Administration Building) (tax-exempt) and series 2018B (Vermont Corridor County Administration Building) (federally taxable).

--Los Angeles County Regional Financing Authority lease revenue refunding bonds, 2022 (Vermont Manchester Social Services Refunding Project).

Security Structures for Related Ratings

The authority's lease revenue bonds are payable from the county's facility lease rental payments to the authority and are secured by a portfolio of real estate assets pledged as collateral under a 2015 master lease between the county and the authority. The county's outstanding COPs are payable from the county's facility lease rental payments to the Parking Authority of the County of Los Angeles, the Sonnenblick-Del Rio El Monte Asset Leasing Corporation and the Sonnenblick-Del Rio West Los Angeles Leasing Corporation. The county covenants to budget and appropriate annually sufficient lease rental and COP payments from any source of legally available funds, subject to abatement.

The Los Angeles County Capital Asset Leasing Corporation's lease revenue bonds (LAC-CAL equipment program) are payable from county departments' equipment lease rental payments to the corporation.

The series 2018 lease revenue bonds (Vermont Corridor County Administration Building) are payable from the county's lease rental payments to Los Angeles County Facilities, Inc.

for use and occupancy of the new Vermont Corridor County Administration Building and adjacent parking garage constructed using the bond proceeds. The series 2022 lease revenue bonds (Vermont Manchester Social Services Refunding Project) are payable from lease rental payments to the authority for use and occupancy of the Vermont Manchester social services building, which houses the county's departments of public social services, children and family services, child support services and mental health.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Los Angeles County (CA) [General Government]	LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
Los Angeles County (CA) /Issuer Default Rating - General Government/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

Los Angeles County (CA) /Lease Obligations - Non-Standard - Vermont Corridor/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Los Angeles County (CA) /Lease Obligations - Non-Standard/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Los Angeles County (CA) /Lease Obligations - Standard/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Los Angeles County (CA) /Operating Cashflow/1 ST	ST	F1+ Affirmed		F1+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Los Angeles County Regional Financing Authority (CA)	EU Endorsed, UK Endorsed

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US Public Finance Infrastructure and Project Finance North America United States